Statement of

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International

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"Credit Crunch: A Hearing on the Effects on Federal Leasing and Construction"

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Good morning Chairman Norton, Ranking Member Graves, and members of the Subcommittee. Thank you for holding this important hearing on the impact the current credit crunch is having on the leasing and construction of federal buildings. I am Dick Purtell, Portfolio Manager of Grubb and Ellis Management Services, Inc, and I am here today in my role as Chair and Chief Elected Officer of the Building Owners and Managers Association (BOMA) International.

With the rise in delinquencies and defaults on subprime mortgages over the past couple years, it is only inevitable that this financial crisis would ultimately have some impact on commercial real estate. In my testimony today, I will touch on how the current economic circumstance is affecting the renovation of buildings, build-to-suit leases, attracting and retaining tenants as well as rents and occupancy rates.

In general, much of the economic dynamics of the commercial real estate sector can vary due to local market forces. However, one thing our members all across the country acknowledge is that it's becoming increasingly difficult to acquire capital for new projects and renovations, for public buildings as well as those intended for private sector use. Lenders are making it more and more expensive for even the most economically-sound companies to borrow money. And for those whose balance sheets aren't as healthy, it's nearly impossible. Consequently, this has negatively affected building owners wishing to refinance, sell existing buildings or plan for future renovations in which the financing for the project has not yet been secured. It could also become a factor in a building owner's ability to attract and retain tenants, by limiting the tenant improvement packages offered in the future.

An example of where access to capital has made it difficult to liquidate properties is in San Diego, where one BOMA member, who has responsibility for a municipal government's portfolio, has had a number of buildings on the market for over a year at what are considered bargain basement prices. But due to the increased borrowing restraints and cost of funds, he has had trouble finding buyers without having to reduce the price even further. In Philadelphia, we've received reports that building owners are currently moving forward with renovations and improvements that were more than likely already in the pipeline, however plans for renovations in 2009 do not appear to be in the budgets of most.

The increased difficulty to obtain capital for the purposes of developing commercial buildings has also negatively impacted build-to-suit leases. We are hearing that very few build-to-suit leases are being executed at this time. Stricter under-writing requirements, skyrocketing construction costs, combined with the increasing vacancy rate, decreasing effective rent and economic slowdown, has eliminated any new construction. Currently, those build-to-suit leases that are in the works were either begun some time ago or are being financed largely through private equity.

From the federal government's perspective, in areas where there are owners or developers with large existing buildings or buildings under construction that are looking at the government as prospective tenants, current conditions may actually *help* the government, as their demand never goes down. However, it is adversely affecting large build-to-suits, even those for the federal government, due to the uncertainty of financing, capitalization rates, and buyers for the take out. Since in these times, the government is an even more important player in the building and construction industry than it is normally due to its demand for space continuing at a more constant rate than private industry, it becomes even more critical for the government to eliminate barriers and constraints to the government leasing space, especially in build-to-suits that were discussed in previous BOMA testimony before this Committee.

The ability of building owners to attract and retain tenants, as well as to stabilize rents and occupancy rates, are issues that appear to be more sensitive to the local area's supply and demand. Some reports from members have indicated that rents continue to be on the rise, but not quite as rapidly as in recent years, as is the case here in the District. In other markets, the economic slowdown has hurt overall occupancy levels as tenants are struggling to survive. Owners are still trying to maintain the same rental rates, but are now offering significant tenant and broker incentives. In these parts of the country, it is definitely a "tenant's market". In buildings with weak occupancy, owners are having even more trouble making mortgage payments. In some markets, owners are taking a wait-and-see approach to see if the slowing economy leads to tenants shedding unwanted space. Due to the nature of the industry, the possible negative effects in certain parts of the country may not be felt for several years.

If there is an upside to this, it is that the amount of supply coming on line over the next several years will be significantly less, which will have a positive impact on the market overall, from a landlord's perspective.

We thank the Subcommittee for holding this important hearing and hope this testimony has provided some insight on the affect the credit crunch has had on the commercial real estate industry. I welcome any questions you may have.

About BOMA International

Founded in 1907, the Building Owners and Managers Association (BOMA) International is an international federation of more than 100 local associations and affiliated organizations. BOMA International's members are building owners, managers, developers, leasing professionals, medical office building managers, corporate facility managers, asset managers, and the providers of the products and services needed to operate commercial properties. Collectively, BOMA's 17,000 members own or manage more than nine billion square feet of office space, which represents a $100 billion marketplace and more than 80 percent of the prime office space in North America.